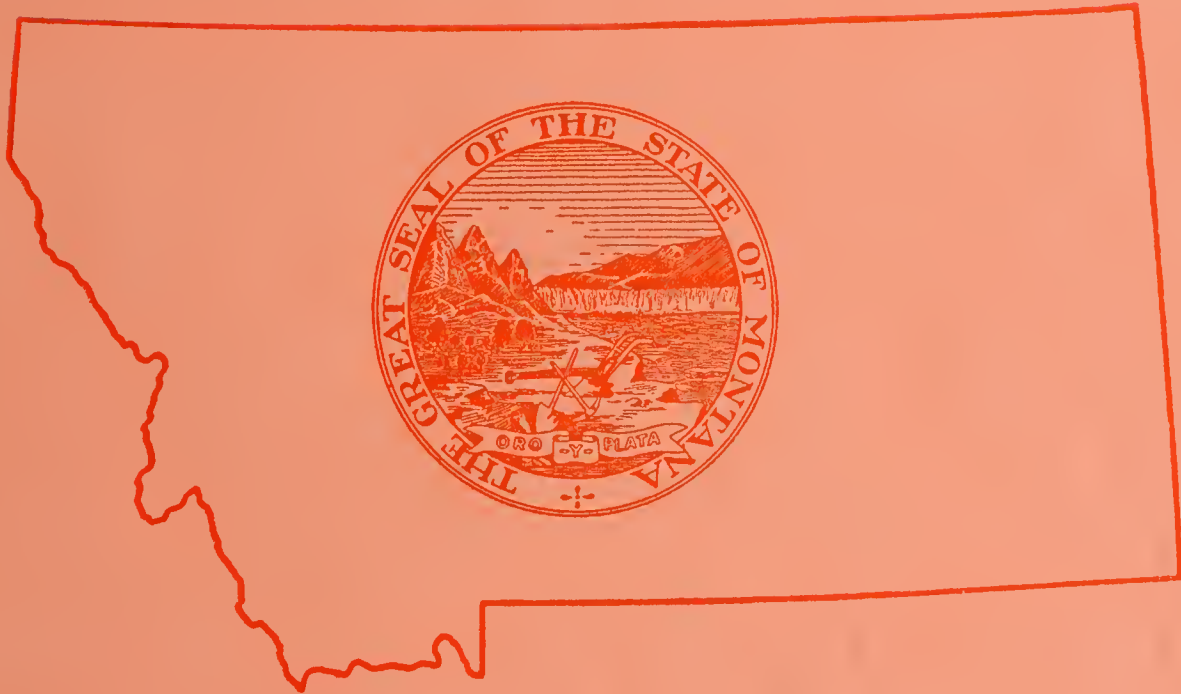


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FISCAL CONTROL



Montana Legislative Council

November 1962

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FISCAL CONTROL

A REPORT TO THE THIRTY-EIGHTH
LEGISLATIVE ASSEMBLY

by the

Montana Legislative Council
November 1962

To Members of the Thirty-eighth Legislative Assembly:

Since its creation the Legislative Council has continuously studied state fiscal procedures. The 1957-58 Council recommended the inauguration of an executive budget; the 1959-60 Council proposed a number of changes to simplify the claim approval process. All of these recommendations were enacted by the legislature.

This report contains some general background material on fiscal control which is basic to the entire financial operation of state government. Also included are the findings and recommendations of the Council relating to the preparation of warrants and to the legislative post audit. Adoption of the first recommendation would substantially reduce governmental red tape and would result in significant economies without any loss of fiscal control; adoption of the second recommendation would provide the legislature with first hand information on the fiscal affairs of state government and would materially tighten our system of fiscal control.

The Administration subcommittee supervised the research involved in producing Chapters I and II of this report. Chapter III was prepared under the direction of the Fiscal Control subcommittee.

Respectfully submitted,

WILLIAM R. MACKAY

Chairman

Montana Legislative Council

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1961-1962

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Internal Control

Economy and efficiency in government are desirable, but adequate fiscal control cannot be sacrificed to obtain these two objectives. Fiscal controls can be either internal or external; a combination of both is essential for good management. Internal control consists of the procedures and organization developed within the government to safeguard its assets, check the accuracy and reliability of accounting data, promote operational efficiency, and prevent misuse of public funds.

The three state agencies that are primarily responsible for controlling and accounting for the expenditure and receipt of state moneys are the state controller, state auditor and state treasurer. The expenditure and receipt of public moneys require the participation of each of these offices.

There are some exceptions to normal fiscal procedures, particularly in the case of departments that periodically pay benefits or refunds to individuals. Some of these agencies prepare their own warrants based on claims that are not preaudited in detail by the state controller. These exceptions are probably justifiable. Internal controls within an agency can be established by dividing the various fiscal procedures between divisions or personnel. It is not necessary in all cases to provide a centralized pre-audit of expenditures. However, it *is* desirable for all moneys collected by a state agency to be deposited in the state treasury. Three state agencies that regularly collect public moneys deposit none of it in the state treasury.

Individual state agencies are responsible for preparing claims which are submitted to the state controller for pre-audit and posting. After a claim has been processed by the state controller it is sent to the state auditor's office. There the claim and supporting bill are visually compared, warrants are typed, and accounts posted. After the warrant is typed, the amount and name of the payee are visually compared with the amount and name on the outside of the claim; however, this is nothing more than proof reading to reduce the possibility of error in transcribing data from the claim to the warrant. Personnel in the auditor's office have access only to documents sent there by the controller; no independent source of information is available.

Even if the examination of claims in the auditor's office were conducted according to specific standards, the desirability of additional review at this point would be doubtful. Pre-audit at several stages results in excessive delay and inefficiency in the transaction of the government's fiscal affairs.

There is also unnecessary duplication of financial records kept by the controller, auditor and treasurer. Insofar as expenditures are concerned appropriations accounts are maintained in triplicate and fund accounts are maintained in quadruplicate. Fund accounts for receipts are also maintained in quadruplicate.

Much duplication exists under the guise of fiscal control in Montana. Some duplication is needed to establish necessary checkpoints; however, duplication does not inevitably result in fiscal control. Control procedures must be consciously and deliberately established after an evaluation of the entire fiscal process. In effect, Montana's fiscal system sanctions repetitive accounting as a substitute for adequate procedures to insure accountability.

It is not necessary that a number of independent offices, much less constitutionally elected officials, jointly participate in the receipt and disbursement of state money. Sound internal control may be established within most departments subject to some review by a central state agency.

Orville E. Hodge, the elected auditor of public accounts for the state of Illinois, stole over two million dollars from the state of Illinois during his forty-two months in office. The report and recommendations of the special committee to investigate these irregularities revealed that many of the defects found in the organization and procedures in Illinois are also present in Montana. The committee observed that "a fundamental defect was that Illinois' governmental struc-

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ture gave the appearance that effective fiscal controls existed and were functioning. But the security was more of form than substance."

Three of the major recommendations of the Illinois committee were to eliminate the elective offices of state auditor and state treasurer and to create the office of legislative post auditor. The committee said that maintaining the elective offices of auditor and treasurer as independent islands of executive authority is "utterly indefensible."

These recommendations of the Illinois committee are only mentioned as an example of the action taken in one state to tighten its fiscal control. Recommendations of the Montana Legislative Council appear below.

State Warrant Writing

Approximately 37% of all state warrants are prepared in the office of state auditor. Almost all of the 620,000 warrants prepared annually by state agencies other than the state auditor are processed on automatic accounting machines.

Warrants are hand typed in the auditor's office directly from claims that have already been pre-audited, coded and posted in the state controller's office by means of punching different classes of information into IBM cards. With only minor changes in equipment and procedures, the same cards could be used to automatically produce card-type warrants.

Over twenty years ago the procedures for warrant writing were described as "involved and cumbersome"; the use of machines to modernize the warrant writing operation was suggested at that time.

Warrant preparation is not a constitutional duty; there is little doubt that it can be transferred without constitutional amendment. The Supreme Court of Montana has said that if the framers of the constitution intended that all warrants be issued by the auditor they would have experienced no trouble in so framing the provision, but that they evidently intended that at some future time warrants or orders might be issued by some other officer.

The preparation of warrants is a purely clerical function and provides no additional fiscal checks or controls.

The Council recommends that the preparation of all state warrants be put under the control of the State Controller. The proposed legislation is flexible enough to allow agencies and institutions with adequate equipment and proper internal controls to prepare their own warrants. All other warrants would be prepared in the controller's office.

The estimated net annual savings resulting from transferring warrant writing from the auditor's office to the controller's office is \$23,500. The adoption of this recommendation would also permit mechanical sorting and posting of warrants in the state treasury at a substantial savings to the state.

External Fiscal Control: The Legislative Post Audit

Reduced to the simplest definition, a post audit is a review of fiscal transactions after they have been completed. Everyone agrees that some kind of independent post spending examination is an essential element of good fiscal control. Where does this function belong in the structure of government?

If the job of post auditing is given to the executive branch of government, the illogical situation exists, contrary to good fiscal principles, of an agency auditing its own accounts. Since the function is outside the traditional role of the judicial branch, theoretically this leaves only the legislature as the proper branch to perform the post audit. If we are to preserve the fundamental tenets of our governmental system and retain a balance of power among the three branches of

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government, if we are to protect the people from the dangers of too great a concentration of power in one branch, we must give the responsibility for post auditing to the legislative branch of government. Currently twenty-one states have assigned post auditing to an agency of the legislative branch.

A legislative post audit could help correct the imbalance of power that has resulted from giving the governor budgeting powers. There has been no parallel emphasis on the creation or improvement of legislative tools to enable the legislature to keep abreast of developments in the executive branch and to make prudent legislative policy with respect to it. The expansion and increase in complexity of the executive branch challenges the legislature's ability to maintain its role as a separate and equal branch of government, exercising checks on the executive branch.

Responsible government demands that the representative body be held to final accountability for fiscal policy. But this responsibility cannot be met if post auditing is exercised by the executive branch or by an independently elected auditor. The legislature has the right to get a complete, unbiased financial picture of state governmental operations, and, human nature being what it is, there is some reason to expect that its best chance of getting such a picture might be from its own agent.

An analogy can be drawn to private business. Generally a post audit for a corporation is made to assist the board of directors and stockholders to determine whether capital and earnings are being prudently employed. The post audit is made at the direction of the board of directors acting for the stockholders. It is generally accepted governmental fiscal practice to require that a post audit of a governmental agency be addressed to the body which provides the funds for the activities undertaken by the agency. That body is the legislature.

In Montana, the state examiner is required by law to examine all state agencies and institutions "having the control, management, collection or disbursement of any public moneys of any character or description." However, thirty-seven state agencies that regularly spend state moneys are *never* examined as a result of the interpretation of the law by the state examiner. In fact, even when an agency is examined, only programs that involve the collection or disbursement of *cash* are subjected to scrutiny.

Not only is the examination of state agencies by the state examiner contrary to our system of constitutional checks and balances, it is a function that is essentially alien to the primary programs of the state examiner's office—the examination of municipalities and private financial institutions.

The Council recommends that an auditor responsible to the legislative assembly be given responsibility for post auditing all state agencies. The purposes of this audit would be to determine if (1) the agency is carrying on only those programs or activities authorized by the legislature, and it is conducting them efficiently; (2) expenditures are made only in furtherance of authorized activities and in accordance with applicable laws and regulations; (3) the agency collects and accounts properly for all revenues and receipts arising from its activities and the assets of the agency are adequately safeguarded; and (4) reports and financial statements by the agency disclose fully the nature and scope of the activities conducted, and provide a proper basis for evaluating the agency's operations.

The Council recommends the creation of a bipartisan legislative audit committee consisting of two senators and two house members that would meet quarterly to advise and consult with the legislative post auditor, who would be appointed by the committee. The auditor, however,

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would be responsible solely to the legislative assembly and would hold office for a term of two years.

Neither the auditor nor the committee would have any direct powers of enforcement. The auditor's report to the legislature could include comments, recommendations and suggestions, but by law he would be prohibited from "otherwise influencing or directing executive or legislative action."

The cost of an effective post audit program would approximate \$80,000 annually. However, with offsetting costs resulting from a reduction in the state examiner's appropriation, the net expense of establishing a comprehensive legislative post audit in Montana would probably not exceed \$50,000 annually.

Chapter I

INTERNAL FISCAL CONTROL

While economy and efficiency in government are desirable, adequate fiscal control must not be sacrificed to gain these two objectives; in fact, fiscal procedures that do not provide adequate control are not really efficient. Fiscal controls can be either internal or external; a combination of both is essential for good management. This chapter is concerned primarily with internal control.

The controls and procedures that are developed for the processing of claims, collection of cash and disbursing of cash through warrants or checks, are internal controls. Internal control has been defined as follows:

Internal control comprises a plan of organization and all of the coordinate methods and measures adopted within the government to safeguard its assets, check the accuracy and reliability of its accounting data, promote operational efficiency, and encourage adherence to prescribed managerial policies.¹

More specifically, procedural internal controls are steps incorporated into daily fiscal transactions:

- (1) To provide convenient check points for revealing errors;
- (2) To ensure accountability for the receipt and expenditure of public money; and
- (3) To maintain adequate records of fiscal transactions to serve as a basis for audit.

The external control is an independent post audit. It is external because it is achieved by an agency independent of the administration—usually the Legislature. The post audit normally involves an unscheduled investigation in depth of selected transactions, instead of a general review of all transactions. The legislative post audit is fully discussed in Chapter III of this report.

Description of Existing Fiscal Procedures

The three central state agencies that are primarily responsible for controlling and accounting for the expenditure and receipt of state moneys are the state controller, state auditor and state treasurer. With some exceptions noted later, the general fiscal procedures are as follows.

EXPENDITURES

The first phase in the expenditure of public moneys is the preparation of a claim by the spending department (except when a requisition through the state purchasing division and a state purchase order issued by that division precede the preparation of the claim.) The claim is, in effect, a voucher, and is supported by a bill received from a vendor or supplier of goods or services, or by a payroll or travel claim.

The bill and claim are submitted in duplicate to the accounting division of the state controller's office where they are pre-audited to ascertain that (1) the proper authorizing signature is present, (2) the claim and supporting documents are mathematically and clerically accurate, (3) the proper appropriation and fund is charged and that the appropriation is available and adequate, and (4) the expenditure is not illegal. The law provides that item (2) above may be accomplished on a spot-check basis. The claim is then coded and posted by account and fund.

¹ *First Report of the Joint Legislative Audit Committee, State of California, (1958), p. 20.*

The original claim and bill are then sent to the state auditor's office where they are visually compared. Warrants are typed from the claim and the expenditure is again posted by appropriation account and by fund. The warrant is then either returned to the spending agency or mailed to the payee.

When the paid warrants are cashed they are picked up from the clearing banks in Helena by the state treasurer. The warrants are first sorted by hand as to fund and numerical sequence and then are posted to a daily disbursement sheet. Fund ledgers are posted from the daily disbursement sheet.

Cancelled warrants are returned to the state auditor's office along with a copy of the disbursement sheet. The cash disbursements ledger in the auditor's office is posted by fund from the disbursement sheet.

RECEIPTS

Deposits of state money with the state treasurer are accompanied by temporary receipts identifying the fund to which the money is to be credited. Official receipts are prepared in quadruplicate by the treasurer. One copy is sent to the depositor, one to the state controller, one to the state auditor and one is retained. From the copy of the official receipt retained in the treasurer's office the receipts are posted to fund ledgers.

In the auditor's office the cash receipts ledger is posted by fund from the copy of the treasurer's official receipt.

In the controller's office receipts are posted by fund from the copy of the official treasurer's receipt.

EXCEPTIONS TO "NORMAL" FISCAL PROCEDURES

Certain state agencies that periodically pay benefits or refunds to individuals do not follow what might be called "normal" fiscal procedures. Examples are the Public Employees Retirement Board, Industrial Accident Board, Unemployment Compensation Commission, Board of Public Welfare and State Board of Equalization. These agencies all prepare their own warrants for refund or benefit payments; the claims supporting these payments are not pre-audited in detail by the state controller.

These exceptions are probably justifiable. The procedures and organization established to provide internal control are not ends in themselves but are only means to an end; that end is achieving adequate fiscal control of the receipt and spending of state moneys.

Procedures necessary to insure proper internal control for a small state agency without a trained accountant and without enough personnel to provide fiscal check points within the agency, may be entirely different from those necessary for a large organization.

Internal controls *within* an agency can be established by dividing the various fiscal procedures between divisions or personnel. In the case of a large, self-contained state agency with a great volume of business, the virtual elimination of pre-auditing by a central state agency may not in any sense weaken internal controls and may promote efficiency and economy in the operation of government. This is particularly true where a large number of refunds or benefits are paid periodically.

Even where normal operating expenses of state agencies are involved, there have been recommendations adopted in some states to minimize a centralized pre-audit.

The legislative auditor of California recommended:

That the final authority for the approval of claims prior to payment be placed with the chief administrative officers of the various agencies,

That the statutory duties of the state controller as they relate to the audit of claims against the state be changed to relieve him from liability with respect to warrants drawn in reliance upon certification of claim schedules by authorized employees of state agencies, and

That the state controller's examination of claim schedules submitted by state agencies be limited to a determination (1) that claim schedules are certified by properly designated agency representatives, (2) that the appropriations shown on the claim schedules are available to the particular agencies, and (3) that sufficient unexpended balances are available to cover the amounts claimed.²

The report and recommendations of the Illinois Budgetary Commission investigating the case of Orville E. Hodge found that one of the weaknesses in the state fiscal system was "over-reliance on centralized pre-audit in which every item of expenditure is supposedly subjected to thorough check by a central fiscal office." The Illinois report concluded that the responsibility for pre-auditing expenditures should be lodged with the agency authorizing the expenditure, with the review resting in a post audit.

The recommendations of the 1959-60 legislative council to simplify the pre-audit procedures in Montana, which were enacted by the 1961 legislative assembly, are consistent with this philosophy.

There is undoubtedly a point beyond which the centralized pre-audit or processing of expenditures cannot be simplified. Perhaps the standards established above by the auditor-general of California express this minimum. Thus, the "pre-audit" is virtually eliminated. Instead a control point is established to insure that the proper signature is on the claim and that a state agency spends no more money than the legislature authorized it to.

It is probable that sometime in the future the centralized processing of expenditures in Montana will be simplified to this extent. Detailed pre-audits of special types of expenditures such as mileage of sheriffs in transporting prisoners and for items covered by state purchasing laws would probably be continued.

A different question arises, however, when a state agency collects and spends money without the funds ever "touching base" in the state treasury. While there may be various ways to simplify and expedite the expenditure of public moneys, such as the imprest fund system used by the state board of public welfare, it should probably be a minimum requirement that every state agency initially deposit public moneys in the treasury. The state board of dental examiners, state board of pharmacy and the teachers' retirement board deposit no money in the state treasury.

Evaluation of Existing Procedures

PROCESSING OF CLAIMS

In the auditor's office the claim and bill are visually compared, warrants are typed, and accounts are posted. Transcribing the name of payee and amount from the claim to the warrant is a clerical function; if any control were provided by the state auditor it would be in the examination of the claim or in the posting of accounts.

² *First Report of the Joint Legislative Audit Committee, State of California*, (1958), p. 19.

After the warrant is typed the amount and the name of the payee on the warrant are visually compared with the amount and name on the outside of the claim. In other words, the warrant is proofread against the claim to reduce the possibility of an error in transcription. All the information necessary to prepare the warrant is written on the outside of the claim. Even when the claim is opened and compared to the bill, no control is provided. The auditor only sees what the controller wishes him to see; he has access only to documents sent to him by the controller. Again, this is only an additional proofreading.

Personnel in the auditor's office admit that the only way a fraudulent claim would be detected is through information "read in the paper" or by having "heard a rumor." However, even if the examination of claims by the auditor's office was thorough and was conducted according to specific standards, the desirability of an additional review at this point is doubtful. "If statutes or practices require pre-audit at several stages, there is an inevitable tendency to duplicating effort, to excessive delay, and to resultant inefficiency in the transaction of the government's fiscal affairs."³

The auditor posts appropriation and fund accounts as does the controller. Both work from an identical source—the claim. In maintaining these accounts the auditor has available to him no information that is not available to the controller when the controller posts identical accounts. This amounts to doing the same work twice with the hope that any errors previously committed will be caught the second time around. At the end of the month the controller and auditor reconcile their accounts; however, neither office actually audits the other. They simply compare information to determine if any honest errors occurred that should be corrected. The books of each office are under the exclusive control of personnel in that office.

DUPLICATION OF FINANCIAL RECORDS

The controller and auditor both maintain permanent records of receipts and expenditures by fund and appropriation. The treasurer maintains records of all receipts and expenditures by fund. In addition, each operating agency maintains a record of receipts and expenditures. Thus, insofar as expenditures are concerned, appropriations accounts are maintained in triplicate and fund accounts are maintained in quadruplicate. Fund accounts for receipts are also maintained in quadruplicate.

The maintenance of multiple records is not necessary. Griffenhagen and Associates evaluated this duplication as follows:

The accounting records maintained by the state auditor and the state accountant [now state controller] are not direct duplications in composition but they do show a direct duplication in responsibility for the maintenance of accounting records. The state auditor maintains records relative to the distribution of receipts according to funds as does the state treasurer and state accountant. The state auditor maintains records relative to the distribution of disbursements according to funds and appropriations. The state treasurer maintains records relative to the distribution of disbursements according to funds. The state accountant maintains records of disbursements according to funds and appropriations. It is to be understood that each of these officers maintains his records for different reasons, but under a unified system only one set of records would need to be maintained to meet all requirements.⁴

Conclusion

Much duplication exists under the guise of fiscal control in Montana. Some duplication is needed to establish necessary check points; for example, the posting operation in the controller's

³ Jesse Burkhead, *Government Budgeting* (1956), p. 362.

⁴ Griffenhagen & Associates, *Financial Administration*, Report No. 48 (1941), p. 8.

office is duplicated when punch cards are independently verified by a second operator. However, duplication does not inevitably result in fiscal control; control procedures must be consciously and deliberately established after an evaluation of the entire fiscal process.

It is a safe generalization that inefficiency in government accounting most frequently stems from an institutional arrangement that sanctions repetitive accounting as a substitute for an adequate system to ensure accountability. The control points should be limited, and no one point should perform the same operations or record transactions in the same way as another control point. But at these points there is need for the application of what might be termed the principle of adequate documentation. Each control must be supported by documentary evidence. Inadequate documentation encourages the misappropriation of funds. Superfluous documentation inhibits effective administration.⁵

It is certainly not necessary that a number of independent offices, much less constitutionally elected officials, jointly participate in the receipt and disbursement of state money. Sound internal controls may be established by restricting the participation of particular personnel within each department to one phase of the process.

The essence of an effective system of internal control is the segregation of duties in such a way that the persons who are responsible for the custody of the assets and conduct of the operations have no part in the keeping of, and do not have access to, the records which establish accounting control over the assets and the operations. Duties of individuals should be so divided as to minimize the possibility of collusion, perpetration of irregularities and falsification of the accounts. The objective is to provide the maximum safeguards practicable in the circumstances, giving due consideration to the risks involved and the cost of maintaining the controls.⁶

The existence of a rigid constitutional structure establishing independent fiscal offices not only fails to guarantee effective fiscal control, but actually inhibits the cooperation and periodic re-evaluation essential to sound fiscal procedures.

The State Constitution has much influence on the plan of organization, as it establishes the 11 separate elective officers which head the Executive Branch of the government. This diffusion of authority and responsibility for administration of the State Government has been criticized by legislative committees, civic groups, students of government, and others. This diffusion of authority, sometimes confused with the principle of checks and balances (which actually applies to the traditional division of government into Legislative, Executive, and Judicial Branches and is not a principle which requires hobbling the Executive Branch) is a hindrance rather than an aid to a sound system of internal control.⁷

While minor procedural changes could perhaps improve internal control, it is improbable that stringent internal controls could be imposed without bogging down the system in a mire of red tape. Adequate internal controls can make theft awkward or difficult; but more important, they will provide a written record of transactions to later serve as the basis of an unscheduled post audit. External control in the form of an independent post audit is the most effective continuing means of deterring or disclosing theft.

Even if rigid safeguards were established within the central fiscal offices, the possibility of fraudulent claims by operating departments would not be eliminated. Protection against misappropriation or misuse of public funds by an operating department can best be provided by a post audit.

⁵ Jesse Burkhead, *Government Budgeting*, (1956), p. 370.

⁶ *First Report of the Joint Legislative Audit Committee, State of California*, (1958), p. 21.

⁷ *Ibid.*, p. 21.

The Case of Orville E. Hodge

Orville E. Hodge was the elected auditor of public accounts for the state of Illinois. During the forty-two months Mr. Hodge served in office \$2,000,000 in state funds were stolen. The report and recommendations of the special committee to investigate these irregularities reveal that many of the defects found in the organization and procedures in Illinois are also present in Montana.

The special committee investigating the irregularity occurring in the office of the Illinois auditor was not concerned primarily with "efficiency and economy" in government; the main purpose of the investigation and recommendations was to prevent the recurrence of misappropriation of public moneys.

One of the first observations of the committee was:

The pattern of independent, largely unintegrated, autonomous constitutional offices provided by the constitution of 1870 still remains. Perhaps the pattern was attune to the needs and tenor of that era, but certainly not to present day demands and problems. This so-called independent office autonomy served in substantial part, though not the sole contributing factor, to supply opportunities for the shocking misfeasances and irregularities indulged in by Mr. Hodge and others, and, equally important, to encourage abuses and to delay discovery and exposure thereof.⁸

The committee noted that "a fundamental defect was that Illinois' governmental structure gave the appearance that effective fiscal controls existed and were functioning. But the security was more of form than substance."⁹

Some of the constitutional and statutory weaknesses that the committee reported were (1) over-reliance on a centralized pre-audit in which every item of expenditure is supposedly subjected to thorough check by a central fiscal office; (2) unnecessary duplication in disbursing procedure by the offices of auditor and treasurer, without making either office a true check on the other; (3) failure to include a substantial part of the state's financial operations under the supervision of a staff agency responsible to the state's chief executive, the department of finance; (4) failure to tie-back the post-audit procedure to the general assembly, which is the appropriating body; and (5) combining state financial functions and examinations and supervising of private financial institutions in one office—two types of activities calling for different professional qualifications and experience.

Three of the major recommendations of the Illinois committee were to eliminate the elective offices of state auditor and state treasurer and to create the office of legislative post-auditor. The reasons given by the Illinois committee for these recommendations follow:

1. Elimination of the office of auditor.

It can readily be seen that the auditor's executive responsibilities are limited. With the exception of the matter of administration of the laws respecting private financial institutions, the auditor has few discretionary powers and he could be classified as a 'bookkeeper' for the state.

Administrative and even political accountability should be vested in as few top-level state officials as possible. This is desirable not only for the people who quadrennially are called upon to select the stewards of their governmental affairs, but also for the efficient functioning of state government demanded by present day needs. Government has become too complex for even a well informed citizenry intelligently to determine

⁸ *Report and Recommendations to Illinois Budgetary Commission with Respect to Investigation on Behalf of the Commission as to Operations of the Office of Public Accounts of Illinois under Orville E. Hodge* (1956), p. 8.

⁹ *Ibid*, p. 9.

whether the operations of the auditor's office are performed satisfactorily and who is well qualified for the position.

Furthermore, the reduction in the number of elective officers seems wise in view of the rising cost of conducting political campaigns. In this connection it should be observed that Mr. Hodge openly stated that a principal motivation for his speculations was the need to obtain sufficient funds to finance his political campaigns.

We have recommended the elimination of the office of auditor of public accounts, and establishment in its stead of two additional offices to which should be transferred the majority of duties now assigned to the auditor: (1) legislative auditor, responsible to the general assembly, (2) department of financial institutions, responsible to the governor.¹⁰

2. Elimination of office of treasurer.

It is obviously unnecessary to elect an officer who exercises so little discretion and independent judgment as does the state treasurer. The arguments which are advanced in this report for the elimination of the office of auditor . . . as an elective office apply with even greater force to the office of treasurer. In addition to the considerations already noted, the cost of campaigning and the inability of the electorate to become familiar with the candidates and the duties of the office are themselves compelling reasons for eliminating the office as an elective one and providing for appointment by the governor. Appointment by the chief executive will strengthen executive authority and responsibility for the conduct and management of state affairs. Maintaining the office of treasurer as an independent island of executive authority is utterly indefensible.

We therefore, recommend that the office of state treasurer be eliminated as an elective constitutional office and that the state treasurer be appointed by and responsible to the governor, by and with the consent of the senate.¹¹

3. Creation of office of legislative post-auditor.

We recommend that the responsibility for post-audit of state agencies rest with the legislature and there be established a legislative audit commission for this purpose which will appoint a legislative auditor who will be responsible for the post-audit of all state agencies.¹²

These recommendations and remarks of the Illinois committee are included in the report only as an example of the action taken in one state to tighten its fiscal control. Alaska, New Jersey and Hawaii, each of which elect only two state officials, are states which reflect a trend to eliminate minor offices from the ballot.

Specific recommendations of the council appear in Chapters II and III of this report.

¹⁰ *Ibid*, pp. 67, 68.

¹¹ *Ibid*, p. 58.

¹² *Ibid*, p. 82.

Chapter II

STATE WARRANT WRITING

About 37% of all state warrants are prepared in the office of state auditor. Almost all of the 620,000 warrants prepared annually by state agencies other than the state auditor are processed on automatic accounting machines.

Warrants prepared in the auditor's office are hand-typed directly from claims. A copy of each claim has already been pre-audited, coded and posted in the state controller's office. The posting is accomplished by punching eleven different classes of information, including the date, amount, and payee's name into an IBM card and then running a series of cards through the machines. With only minor changes in equipment and procedures, the same cards could be run through a printing machine to automatically produce warrants.

The machines would also prepare warrant registers and sort and reconcile paid warrants automatically. These are now all manual operations in the auditor's and treasurer's offices.

In 1941 Griffenhagen and Associates characterized the procedures for warrant writing as "involved and cumbersome" and mentioned "the possibility of improving and modernizing the warrant writing procedures by the installation of equipment to write the warrants, produce the warrant register, and take the necessary totals in one operation . . ."¹ With the remarkable development in automatic data processing equipment in the past twenty years, this advice is even more persuasive today.

Constitutional Considerations

There is little doubt that the statutory duty to draw warrants can be removed from the office of state auditor without constitutional amendment. The supreme court of Montana, in *State vs. State Board of Examiners*, 74 Mont. 1, at page 8, said:

We find no provision in the constitution requiring that all state warrants be issued by the State Auditor, and no statutory provision to that effect. The constitution (Sec. 1, Art. VII) provides for a State Auditor, and had its framers intended to declare that all state warrants shall be issued by this particular officer, they would have experienced no trouble so framing this provision. By the use of the phrase "the proper officer" they evidently intended that, at some future time, special funds in the treasury might be handled by some other office than that of the Auditor, and warrants or orders issued by such other "proper officer".

Whether all general fiscal duties could be removed by statute from the state auditor's office, however, is doubtful. While personnel in the auditor's office do not actually "audit" claims or warrants against the state, they do visually compare claims to warrants prepared by them, as well as maintain appropriation and fund accounts. These are general fiscal duties that could be regarded as implied constitutional powers. Courts in some jurisdictions have held that the legislature may not remove "traditional" powers and duties of constitutional offices, that is, powers and duties commonly understood to be attached to the office at the time the constitution was framed. For this reason it would probably be necessary to retain in the office of auditor some general fiscal duties.

Fiscal Control

The preparation of warrants is a purely clerical function and provides no additional fiscal checks or controls. Neither is the review of claims and posting of accounts by the auditor a neces-

¹ Griffenhagen & Associates, *Financial Administration*, Report No. 48, (1941), p. 8.

sary function; *the only reason for the auditor to retain those latter duties is to avoid an invalidation of the proposed legislation on constitutional grounds.*

Even if the duty to review claims and maintain accounts were removed from the auditor's office (which is not recommended at this time) the following checks and controls would exist.

1. The executive budget—Although the preparation of the executive budget does not provide detailed fiscal supervision, it serves as an effective review of the broad fiscal activities of state agencies.

2. The spending departments—Each agency of state government processes expenditures and receipts and maintains financial records. Each agency receives a current monthly financial report from the controller's office indicating the status of their appropriation account or fund balance, which affords it an opportunity to reconcile its balance.

3. Pre-auditing of claims—The state controller pre-audits all claims against the state to ascertain (a) that the proper authorizing signature is present, (b) that the claim and supporting documents are mathematically and clerically accurate, (c) that the proper appropriation and fund is charged and that the appropriation is available and adequate, and (d) that the expenditure is not illegal.

4. The verification of postings—In the controller's office the information on each claim is recorded on an IBM punch card. The card is then verified independently by another punch card operator who works from the original source—the coded claim. The effect of this operation is to doublecheck every posting.

5. When paid warrants are returned, the treasury posts disbursements and reconciles balances with the warrant-issuing agency. Whether paid warrants were cleared under the supervision of an elected state treasurer or the treasury division of a department of administration is immaterial. In either case adequate internal control could be established by requiring that paid warrants be processed by personnel other than those responsible for preparing warrants.

6. The post-spending examination by the state examiner or by a legislative post-auditor.

Chapter I of this report is devoted to fiscal control; an understanding of the principles described in that chapter will enable the reader to better evaluate the recommendations relating to the office of state auditor that follow.

Recommendation

The Council recommends that the preparation of all state warrants be put under the control of the state controller. The proposed legislation would allow agencies with adequate equipment and procedures to write their own warrants with the permission of, and under the supervision of the controller. All other warrants would be prepared in the controller's office. (For copy of bill see *Appendix A.*)

At the present time almost two-thirds of state warrants are prepared outside the auditor's office. In most instances state agencies preparing their own warrants do so with specific legal authority; in some instances there exists only an extra-legal agreement.

As mentioned in Chapter I of this report, the continuation of a trend toward de-centralizing state fiscal procedures and internal controls is foreseeable. Several of the large university units now have comprehensive data processing installations. For example, the state college now processes its entire payroll by IBM machine. Punch cards for each warrant are prepared which automatically print a card bearing the payee's name and address along with a data sheet listing all of the information necessary to prepare the warrant. The data sheet is sent to Helena where warrants are hand typed, and then returned to the college. Each warrant is slipped in a window

envelope behind the card on which the name and address of the payee is printed and then is mailed out. It now takes more time, and causes more expense to send the claim and data sheet to Helena, than it would to prepare the warrants in Bozeman. The highway commission also has equipment on which it could write its own warrants with little or no additional expense.

When these agencies and institutions can demonstrate the existence of proper internal controls there is no reason why they should not prepare their own warrants—as long as the availability of moneys is reviewed by a state central fiscal agency prior to expenditure. The proposed legislation provides this flexibility.

Significant savings in personnel costs alone would result if warrants now typed in the auditor's office were prepared on automatic accounting equipment in the controller's office that is now lying idle 30% of the time. The auditor's budget for personnel could be reduced by \$32,000; the controller would need an additional \$3,300 for one new position and \$5,200 for equipment modification for a total annual increase to that office of \$8,500. The estimated net annual savings would be \$23,500. The amount needed for costs of supplies and postage should be deducted from the auditor's budget and made available to the controller.

The adoption of this recommendation would also permit mechanical sorting and posting of warrants in the state treasury at a substantial savings to the state.

If the recommendation to mechanize warrant writing in the office of state controller is adopted, there are several additional controls and refinements that should be put in effect in the future.

(1) The present practice of returning warrants to the department originating the claim for transmittal to the payee is an invitation to submit fraudulent claims. Warrants should rarely be returned to the originating department. Payroll warrants might be an exception, but even in this instance there is always the possibility of "padding a payroll" with fictitious names.

Warrants could be mailed directly from the agency that prepared them by printing the payees' address on the warrant and mailing the warrant in a window envelope. This procedure is not suggested for immediate implementation because it would be necessary to prepare a second IBM card for the address. The transition to full mechanization of warrant writing will be smoother if innovations such as this are delayed for a year or two.

(2) Another refinement in disbursement procedures for future consideration is the preparation of permanent IBM cards for state employees and recurring vendors.

At the present time departmental payrolls are prepared in each department each month, even though the basic information on the payroll remains, for the most part, the same from month to month. Warrant writing machines can be programmed to automatically make adjustments for changes in income tax and social security withholdings. If payroll warrants were prepared from permanent cards except in cases where the spending department submitted a notice of change, 4,000 lines of typing on payroll forms would be eliminated each month.

It would also be possible to assign a number to each vendor that had recurring business with the state and to combine the payments due to that vendor into a few warrants each month. At the present time a warrant is prepared for each claim submitted by the various departments, regardless of whether or not an identical vendor is involved. One local office supply house recently received 59 state warrants in one month.

Chapter III

EXTERNAL FISCAL CONTROL: THE LEGISLATIVE POST AUDIT

Reduced to the simplest definition, a post audit is a review of fiscal transactions after they have been completed. The place of the post audit in the sequence of state fiscal procedures has been described as follows:

Our constitutions generally provide for a basic pattern of separation of powers, for a system of checks and balances, and for a government based on law. Applying these fundamentals to the budgeting process, we have seen that budgeting is divided between the executive and legislative branches of government. The first phase—budget preparation—is properly the executive's responsibility. He prepares a plan of action, often in terms of dollars only, but preferably in terms of both programs and dollars to support the programs. Then, through the process of budget review and appropriations, the legislature modifies the programs and the financing and authorizes the executive to carry them out in their modified form. At the next step—budget administration and control—the executive normally, but not always, is responsible for recording what is done and for making any needed adjustments if the financing is found to be different from what was intended. Finally, we come to the step of appraising results—of determining whether the program and financing were carried out by the executive, as directed by the legislature. This step we call the post audit.¹

Every one agrees that some kind of independent post-spending examination is an essential element of good fiscal control. Where does this function belong in the structure of government? The constitution establishes three branches of government — executive, legislative and judicial; obviously the job must be the responsibility of one or another of these. If the executive is given the responsibility for auditing we have the illogical situation, contrary to good fiscal principles, of an agency auditing its own accounts. If the job is given to the judicial branch the courts are assigned a function outside their traditional role. Theoretically then, this leaves only the legislature as the proper place for the post audit function. This choice is verified by a logical interpretation of the balance of power concept.

Faced with several alternatives and the arguments in support of each, how can we determine where the post audit function ought to be, where it belongs? The first step is to examine the basic objective of the organization with which we are dealing. Dealing as we are with state government, this leads us back to the constitution and the fundamental tenets of our governmental system. On the basis of these tenets, we may draw the following conclusions: First, we should do all we can to retain our three part system of government and should encompass all the functions of government within this framework, not outside it or apart from it. Second, we should attempt to retain a balance of power among the three branches of government, always remembering, however, that the purpose of the balance of power is not to frustrate the government in fulfilling the desires of its citizens, but rather to protect them from the dangers of too great a concentration of power in one or another branch of government. If, then, we are to accomplish the objectives derived from these tenets, and we are not to violate logic or tradition, we may conclude that the post auditing function should remain firmly with the legislative branch of government.²

¹ Leroy F. Harlow, paper presented at panel on State Fiscal Organization and Operation, 1961 Western Regional Conference of the Council of State Governments.

² *Ibid.*

The needs of the legislature in the area of fiscal control bear out this theory. The principle has long been firmly established that only the legislative branch of government can levy taxes and appropriate funds. Once won, legislative control over finances for many years presented no critical problems; legislative bodies assumed full responsibility for financial planning and policy determination, not only in theory but in fact. Government itself was simple and relatively small. Taxes were moderate, revenue from an expanding economy was ample, and costs were low. Government functions and services were relatively few.

In the years following World War I, two new influences arose which seemed to challenge the supremacy of the legislative branch in fiscal matters. The first of these was the development and growth of the executive budget system. The second was the tremendous expansion in the number and scope of governmental activities, and the general insistence upon higher standards of competence and efficiency in the administration of these services.

While there is general agreement among authorities that the executive budget—now in almost universal use—is the best form of organization for the performance of the budgeting function, its rapid development and growth did result in an imbalance of power. Under this system, budget planning and execution are under the immediate control of the governor. Legislators sometimes complain that the budget is complicated, hard to understand, and that it is difficult for them to obtain necessary information regarding it from the executive.

Budgets have become exceedingly complicated; but the complexity is due, not to the fact that they are prepared by the executive, but to the steady expansion of existing services and the constant addition of new governmental programs. State government, once relatively small and simple, has been transformed into a business operation of impressive size.

During this period of rapid expansion of the executive branch of government, there has been little parallel emphasis on the creation or improvement of legislative tools to enable the legislature to keep abreast of developments in the executive branch and to make prudent legislative policy with respect to it. While it is not suggested that the legislative branch should keep pace with the executive branch in growth of personnel and expenditures, it is clear that the expansion and increasing complexity of the executive branch challenges the legislature's ability to maintain its role as a separate and equal branch of government exercising checks on the executive branch.

One way in which state legislatures have reestablished a measure of control and influence is by directing a post audit of state fiscal activities. The purpose of a legislative post audit is not only to check the propriety and legality of past fiscal transactions, but also to verify that the intent of the legislature has been followed and to provide the legislature with an independent source of fiscal information for evaluating the executive budget.

Currently twenty-one states have vested responsibility for post auditing in an agency of the legislative branch. These figures are not too impressive until one considers that in 1952 only nine post auditors were responsible to the legislature. It seems safe to say that the general trend is in this direction.

Contemporary literature on the subject unanimously advocates placing the post audit in the legislative branch.

Although the executive branch administers the financial plan and promotes legislation relative to it, control of the public purse in the final analysis rests with the legislative body. This body authorizes the expenditure of money, designates the sources from which money may be collected and shapes the administration to perform the work. For this reason the legislative body should be responsible for the audit of administrative accounts and records so that it may be assured that its orders have been faithfully carried out.

Independence of the auditor rests in part on his owing no political allegiance to the administration. Selection of the head of the agency by means of administrative appointment, by the governor or other executive official, is not a satisfactory method of securing independence of the administration.³

* * * *

A fourth phase of the budgetary process is the post audit, now regarded by most authorities as a legislative responsibility. This audit should be performed by an agency not under the control of those who keep the accounts. And since the legislature ought to be held accountable, finally, for fiscal policy, it should assume the responsibility of post auditing the accounts of all spending agencies.⁴

* * * *

The final phase or step in budget administration is post audit, an accounting activity which should be completely divorced from the executive department. Post auditing is a legislative function, and the auditing authority who performs this duty should be selected by the law making branch. Responsible government demands that the representative body shall be held to final accountability for fiscal policy, if for no other reason because fiscal policy, directly or indirectly, determines to a large extent the character of public administration in general. But this responsibility cannot be met if post auditing is exercised by the executive branch or by an independently elected auditor.⁵

* * * *

The functions of post audit and review belong to the legislature. They are implied in the powers of the legislature to appropriate money to the executive and administrative departments to carry on the activities of state government. They are the means of enforcing financial accountability upon the governor and his department heads—a highly important, but almost neglected, duty of the legislature under the centralized form of state government. Power and authority commensurate with full responsibility for all administrative operations may be accorded the governor as long as the legislature brings him to complete accountability for his acts.⁶

* * * *

A legislative post audit serves to prevent fusion of executive and legislative responsibility. The legislature provides by appropriation for the financing of the activities of the government. The executive is charged with the responsibility of spending those funds to administer the programs determined by the people through their representatives in the legislature. A legislative post audit, rather than an executive post audit, is consistent with the philosophy of checks and balances inherent in our form of separate branches of government.

An analogy can be drawn to private business. Generally, a post audit for a corporation is made to assist the board of directors and stockholders to determine whether the capital and its earnings are being prudently employed. The post audit is made at the direction of the board of directors, acting for the stockholders. It is generally accepted governmental fiscal practice to require that a post audit of a governmental agency be addressed to the body which provides the funds for the performance of and activities undertaken by the agency. That body is the legislature.⁷

³ Vera Briscoe, "Guarding the State's Money," *National Municipal Review*, Vol. XXXV, No. 5 (May 1946) p. 233.

⁴ Leslie Allen, *Oklahoma State Budget Procedures & Practices*, Bureau of Government Research, University of Oklahoma, (January 1957) p. 69.

⁵ *Oklahoma Constitutional Studies*, Oklahoma Constitutional Survey and Committees (1959), pp. 195-96.

⁶ A. E. Buck, *Reorganization of State Government in the United States*, pp. 21, 23-24.

⁷ *Report and Recommendations to Illinois Budgetary Commission* (1956) pp. 59, 60 and 61.

It is very important that the legislature have a post audit agent who can render current and accurate reports on what the executive branch is actually doing with the funds which the legislature has appropriated. The legislature certainly cannot act with any degree of effectiveness unless it can get an accurate picture of what the agency spent in the last fiscal period and for what purpose these funds were used. To be sure, the Governor may include such a report in his budget or if it is not found in the budget, it may perhaps be found in the elected auditor's report, or it might be found in the comptroller's reports. However, the legislature should not be forced to depend on these possible sources for its fiscal information. It has a right to get a complete, unbiased financial picture of state governmental operations, and, human nature being what it is, there is some reason to expect that its best chance of getting such a picture might be from its own agent.⁸

Montana's Post Audit

Is Montana's post spending examination of state agencies responsive to the needs of the legislature? Although the state examiner is required by law to examine all state agencies and institutions "having the control, management, collection or disbursement of any public moneys of any character or description," thirty-seven state agencies that regularly spend state moneys are *never* examined. This is because the state examiner interprets the law as requiring only the examination of agencies that collect or disburse *cash*.

Consequently, even when an agency is examined, only programs that involve the collection or disbursement of cash are subjected to scrutiny. The examinations vary in depth depending on the nature of the agency examined; however, their primary purpose is to verify cash receipts and to reconcile private bank accounts.

The regular examinations made by the state examiner of the financial transactions of the state are little more than a check on the accounting for the cash received and disbursed. No inquiry as to the propriety of the disbursements or the effectiveness of the collecting procedures is made. No expenditure of the state government is audited after a warrant has been issued for its payment. Special examinations of specific agencies may be made that do cover these points, but the state examiner is charged with the examination of the fiscal affairs of local governmental units and this work would prevent his making a more detailed audit of the central fiscal agencies with his present force.⁹

The limitations of the state examiner's examination can be attributed to a number of factors, some of which are (1) inadequate staff, (2) lack of a clear concept of purpose and well defined objectives, and (3) lack of direct or indirect enforcement power.

By giving the state examiner the job of examining state agencies, the legislature has forced upon that office duties that are essentially alien to the primary programs of the state examiner's office—the examination of municipalities and private financial institutions. Eight men are employed in each of these areas, while only two full time examiners work with state agencies. Consequently, the examinations of municipalities and private financial institutions are more comprehensive than those of state agencies, the latter being only minor functions.

Because the examinations produce reports containing information primarily useful to persons involved in financial detail, they are read only by the business managers of the institution or agency examined as a general rule, and not by legislators or other policy-making officials.

The state examiner has statutory supervisory powers over counties—salaries of county and city attorneys can be withheld if illegal practices are not corrected. In the case of state agencies

⁸ Coleman B. Ransome, *The Office of Governor in the United States* (University of Alabama Press, 1956), pp. 283-84.

⁹ Griffenhagen & Associates, *Financial Administration*, Report No. 48, (1941) pp. 18, 19.

no such power exists. It is generally agreed that an independent auditor of state agencies should have no direct powers of enforcement; however, a legislative interim committee receiving reports from a legislative auditor insures a forum to review the auditor's findings, and provides a vehicle to present remedial recommendations to the policy-making body—the legislature.

Examples of information useful to the legislature but not produced by the state examiner's examination are: (1) whether expenditures from state treasury funds are authorized by specific legislative appropriation, (2) whether travel claims by state officers and employees represent necessary travel by the shortest and most economical route, (3) whether there is compliance with statutory requirements that certain funds revert at the end of a fiscal year or biennium, (4) whether the use of contingent revolving funds is strictly in accordance with law, (5) whether state purchasing laws are complied with, particularly with regard to bidding procedures and change orders, (6) whether expenditures for capital items and supplies are verified by independently checking with the supplier, and whether such items are a part of the agency's inventory, (7) whether there is full compliance with laws requiring university units to use student building fees for the accelerated retirement of bonds, and (8) whether there is conformance with general statutes governing fiscal procedures in government and the operations of particular state agencies. For example, the legislative council's study of the state treasury fund structure has revealed repeated violations of state law governing the collection and disbursement of state funds. Moneys for the operation of state agencies are currently being spent from 34 state treasury funds without specific appropriation, despite the fact that the constitution requires legislative appropriation of all moneys disbursed from the state treasury.

What are the objectives of an independent post audit? The stated objectives and procedures adopted by the California Joint Legislative Audit Committee and Auditor General are as follows:

- (1) That the agency is carrying out only those activities or programs authorized by the Legislature and is conducting them efficiently and in the manner authorized.**
- (2) That expenditures are made only in the furtherance of authorized activities and in accordance with the requirements of applicable laws and regulations.**
- (3) That the agency collects and accounts properly for all revenues receipts arising from its activities.**
- (4) That the assets of the agency or in its custody are adequately safeguarded and controlled and utilized in an efficient manner.**
- (5) That reports by the agencies to the Governor, Legislature or central control agencies, disclose fully the nature and scope of activities conducted and provide a proper basis for evaluating the agencies' operations.**

The procedures to achieve these objectives include:

- (1) A study of the pertinent laws and the legislative history to ascertain legislative intent as to the purposes of the activities engaged in by the agency.**
- (2) A review of the policies established by the agency.**
- (3) A review of the procedures, practices, forms of organization (particularly as to the segregation of duties and responsibilities), and the system of reporting, review, and inspection as well as other elements of internal control.**
- (4) A review and analysis, by program, of receipts and revenues, expenditures, and the utilization of assets together with all related control processes as a basis for evaluating the effectiveness with which public funds are applied and properly utilized.**

- (5) The examination of individual transactions, the confirmation of balances with debtors, creditors, and depositories, and the physical inspection of property, to the extent necessary to determine whether:
 - (a) Transactions have been consummated in accordance with applicable laws, regulations and decisions, and have been correctly classified;
 - (b) Resources and financial transactions have been properly accounted for; and
 - (c) Control processes of the agency are functioning effectively.
- (6) The exploration and full development of all important deficiencies encountered and the presentation of recommendations to correct such deficiencies.

Administration of a Post Audit Program

The three methods of organization now prevalent in legislative post auditing agencies in other states are: (1) direct appointment and responsibility of the post auditor to the legislature with no interim supervision, (2) appointment of the post auditor by a special interim auditing committee and supervision by that committee, (3) the inclusion of the post audit in the regular program of an existing legislative service agency such as the legislative council. In most states the second plan has been adopted.

The first method has the advantage of freeing the auditor from the influence and detailed supervision of an interim committee; however, total independence removes the opportunity for communication with legislators that is provided by occasional contact with an interim committee, and also deprives the legislature of the benefits of interim analysis of audit reports. Also, direct appointment by the legislature might not produce the best qualified person because of (1) a shortage of time to screen candidates, (2) the awkwardness of a 150-member appointing body, and (3) the possibility of partisan considerations entering into the appointment.

The second method offers the advantage of insuring that the auditor will be responsible to the desires of a representative group of legislators. If the interim committee is bipartisan, political implications in the appointment of the auditor or in the auditing itself are not likely to arise. One possible disadvantage of the second method is excessive supervision by legislators who want "special investigations" of certain departments that might interfere with the basically administrative nature of the audits. A second disadvantage is the expense of a separate interim committee.

The advantages of the third method are more efficient utilization of existing secretarial and professional staff, coordination of post auditing with general research activity, and savings on travel and per diem of committee members. The disadvantages are again the danger of excessive supervision by a committee, and the possible reluctance of legislators to vest additional responsibilities with the legislative council.

Recommendation

The Council recommends that an auditor responsible to the legislative assembly be given responsibility for post auditing all state agencies. (See bill in *Appendix B*.)

Close supervision of the auditor is not necessary; however, if there is no interim review of audit reports by a policy-making and recommendation-formulating body, problems deserving special study will go untouched, and none of the findings of the post auditor can be translated into policy recommendations or specific legal proposals.

The Council proposes the creation of a special bi-partisan legislative audit committee whose

function would be to appoint the legislative auditor and to periodically advise and consult with him.

The Council also recommends that copies of audit reports of state agencies be submitted to the Council as they are available for review. The Council could then supervise special studies by its own staff where the apparent need existed, and could make policy recommendations and propose specific legislation to the legislature. The auditor would present a final biennial report to the legislative assembly at each session.

The legislative auditor would serve for a two year term so that his performance could be reviewed at each session. However, as a safeguard, a provision for discharging the auditor by the legislative audit committee for misfeasance, malfeasance or nonfeasance in office is included in the proposed bill.

Minimum qualifications of the legislative auditor are expressed in the proposed bill. Ideally the auditor should be a Certified Public Accountant with experience in public auditing. A salary range of \$9,000 - \$12,000 is suggested for the position.

Cost of Post Audit

According to a 1961 Council of State Governments' publication the median salary for a department head of a legislative post audit agency is \$12,000; the range is from \$8,400 to \$19,000.

The number of permanent full time professional personnel also varies greatly; the median is 23. The median of full time clerical personnel is 5.

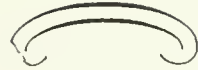
The state examiner's office estimates the present cost of examination of state agencies at \$34,220 annually. This cost represents the equivalent of three full time examiners, supervisory personnel, clerical help, and other expenses. If the post audit is to be effective and is to conform generally with the audit standards stated in the proposed bill, the audit staff would probably have to be doubled. A budget outline for the agency might be as follows:

1 Department head	\$12,000 (maximum)
2 Auditors @ \$8,000	16,000
2 Auditors @ \$7,000	14,000
2 Auditors @ \$6,000	12,000
2 Clerical personnel @ \$3,600	7,200
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Sub-total	\$61,200 personnel costs
Travel and per diem	\$ 8,000
Operation	10,000
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Total annual budget	\$79,200

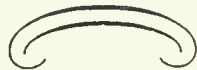
These costs would be partially offset by a reduction in appropriations to the state examiner's office. Of the \$34,200 estimated cost of conducting examinations of state agencies, the state examiner's office estimates that only about \$23,000 could be deducted from their appropriation. The reason given is that the equivalent of one full time examiner is actually a combination of specially hired temporary help plus municipal examiners called in for periods of time to examine

state agencies at the expense of their municipal audits—which are apparently running as far as two years behind. The cost of supervision and general office overhead could not be significantly reduced.

Anticipating increased collections from agencies which are audited, the additional annual cost of establishing a comprehensive legislative post audit in Montana would probably not exceed \$50,000. To defray the cost of recruiting the first legislative auditor, a small appropriation not exceeding \$2500 should be made available to the legislative audit committee during the current biennium.



APPENDIXES



APPENDIX A

-----BILL NO.-----

INTRODUCED BY-----

79-101, 79-103, 79-104, 79-108, 79-109, 79-201, 79-202, 79-203, 79-204, 79-206, 79-1101, 79-1402, 3-233, 3-420, 3-510, 11-1919, 11-1920, 11-1921, 32-1620, 75-1616, 82-1507, 82-1511, 82-1517, 93-2014, 93-2022, 93-2025, 44-405, 46-105, 91-511, 91-518, 66-2333, 66-608, 66-513, 66-2605, 27-417, 26-133, 71-903, 81-1410, 75-1315, 79-1212, 79-1213, 3-2605

A BILL FOR AN ACT ENTITLED: "AN ACT TO REMOVE THE DUTY TO DRAW STATE WARRANTS FROM THE STATE AUDITOR AND TO PUT THE DRAWING OF STATE WARRANTS UNDER THE CONTROL OF THE STATE CONTROLLER; TO AMEND SECTIONS 79-101, 79-201, 79-202, 79-203, 79-204, 79-206, 79-1101, 79-1402, 3-233, 3-420, 3-510, 11-1919, 11-1920, 11-1921, 32-1620, 75-1616, 82-1507, 82-1511, 82-1517, 93-2014, 93-2022, 93-2025, 44-405, 46-105, 91-511, 91-518, 66-2333, 66-608, 66-513, 66-2605, 27-417, 26-133, 71-903, 81-1410, 75-1315, 79-1212, AND 79-1213, R.C.M. 1947; AND TO REPEAL SECTIONS 79-103, 79-104, 79-108, 79-109 AND 3-2605, R.C.M. 1947."

BE IT ENACTED BY THE LEGISLATIVE ASSEMBLY OF THE STATE OF MONTANA:

Section 1. **Drawing of state warrants under control of state controller.** (1) The drawing of warrants on the state treasury is under the control of the state controller. Warrants may be drawn on the state treasury, after the preauditing and approval of claims by the state controller as provided by law, by:

- (a) The state controller.
- (b) State agencies and institutions authorized by law to draw warrants on funds under their control.
- (c) State agencies and institutions authorized in writing by the state controller to draw warrants on funds under their control. The state controller shall not authorize a state agency or institution to draw its own warrants until the agency or institution has demonstrated its ability to maintain adequate reporting procedures and an adequate system of internal fiscal control.

(2) Subparagraph (c) of subsection (1) of this section does not authorize the state controller to exempt a state agency or institution from procedures established by law for the preauditing or approval of claims.

Section 2. **Drawing of warrants under continuing supervision of state controller.** The drawing of warrants by state agencies and institutions is under the continuing supervision of the state controller. The state controller shall establish procedures, regulations and reporting requirements governing the preparation, signing, clearing, cancellation, transmittal, and filing of all warrants drawn on the state treasury, and shall, in writing, inform agencies and institutions drawing warrants on funds under their control of these procedures, regulations and reporting requirements.

Section 3. **Issuance of duplicate warrant.** (1) A duplicate warrant replacing a lost or destroyed warrant may be issued by

- (a) The state controller, or
 - (b) A state agency or institution authorized by law or by the state controller to draw warrants.
- (2) A duplicate warrant must be stamped "duplicate."

(3) A person receiving a duplicate warrant shall deposit a bond with the state controller or with the agency or institution issuing the warrant in double the amount for which the duplicate warrant is issued to protect the state in the event the original warrant is cashed.

Section 4. **Filing of paid warrants.** After processing paid warrants as provided by law, the state treasurer shall send them to the state controller who shall either file them or return them to the agency or institution that prepared them.

Section 5. **Reconciliation with state treasurer.** The state controller shall reconcile fund balances monthly with the state treasurer.

NOTE: Sections 6 through 44 of this bill are only amendments and repeals of existing statutes to bring the code into conformity with the above basic legislation. Consequently, they are not reproduced in this report. The code sections affected are listed in the title.

APPENDIX B

NOTE: Material to be deleted shown in brackets; new material is italicized.

.....BILL NO.....

INTRODUCED BY.....

82-1002, 82-1005, 82-1007, 82-1009, 82-110, 71-206, 4-347, 4-230, 4-231, 5-910, 82-1014, 82-1015, 82-1016, 79-504, 84-4403, 84-4404, 84-4405, 89-403

A BILL FOR AN ACT ENTITLED: " 'THE LEGISLATIVE AUDIT ACT' CREATING A LEGISLATIVE AUDIT COMMITTEE AND THE OFFICE OF LEGISLATIVE AUDITOR AND PROVIDING FOR THE AUDIT OF STATE AGENCIES BY THE LEGISLATIVE AUDITOR; AMENDING SECTIONS 82-1002, 82-1005, 82-1007, 82-1009, 82-110, 71-206, 4-347, 4-230, 4-231 AND 5-910, R.C.M. 1947; REPEALING SECTIONS 82-1014, 82-1015, 82-1016, 79-504, 84-4403, 84-4404, 84-4405 AND 89-403, R.C.M. 1947."

BE IT ENACTED BY THE LEGISLATIVE ASSEMBLY OF THE STATE OF MONTANA:

Section 1. **Title and purpose of act.** This act may be cited as "The Legislative Audit Act." Because the legislative assembly is responsible for authorizing the expenditure of public moneys, designating the sources from which moneys may be collected, shaping the administration to perform the work of state government, and is held finally accountable for fiscal policy, the legislative assembly should also be responsible for the audit of fiscal accounts and records so that it may be assured that its directives have been faithfully carried out. It is the intent of this act that each agency of state government be audited for the purpose of furnishing the legislative assembly with factual information vital to the discharge of its legislative duties.

Section 2. **Definitions.** In this Act

(1) "State Agency" means all offices, departments, boards, commissions, institutions, universities, colleges, and any other person or any other administrative unit of state government that spends or encumbers public moneys by virtue of an appropriation from the legislative assembly, or that handles money on behalf of the state, or that holds any trust or agency moneys from any source.

(2) "Committee" means the legislative audit committee.

Section 3. **Legislative audit committee—appointment and term of members — officers.** The legislative audit committee consists of four (4) members of the Senate and four (4) members of the House of Representatives appointed in the same manner and at the same time as standing committees of the respective houses are appointed. A vacancy on the committee occurring when the legislative assembly is not in session shall be filled by the selection of a member of the legislative assembly by the remaining members of the committee. No more than two (2) of the appointees of each house shall be members of the same political party. Membership on the committee shall terminate with the termination of each member's term of office, or on December 31 of the year following the year in which the appointment was made, whichever event first occurs. The committee shall elect one of its members as chairman and such other officers as it deems necessary.

Section 4. **Meetings.** The committee shall meet once each quarter to advise and consult with the legislative auditor. Committee members shall be reimbursed from the appropriation to the office of legislative auditor for their actual and necessary expenses incurred as a result of such interim meetings.

Section 5. **Appointment and qualifications of legislative auditor.** The committee shall appoint the legislative auditor and set his salary. The legislative auditor shall hold a degree from an accredited college or university with a major in accounting or an allied field and shall have at least two (2) years experience in the field of governmental accounting and auditing.

Section 6. **Appointment of employees.** The legislative auditor may appoint whatever employees are necessary to carry out the provisions of this act, within the limitations of legislative appropriations.

Section 7. **Term and removal of legislative auditor.** The legislative auditor is solely responsible to the legislative assembly. He shall hold office for a term of two (2) years beginning with July 1 of each odd numbered year. The committee may remove him for misfeasance, malfeasance or nonfeasance in office at any time after notice and hearing.

Section 8. **Duties of legislative auditor.** The legislative auditor shall

(1) Audit the financial affairs and transactions of every state agency at least once each biennium.

(2) Make a full, complete and written report of each audit. A copy of each report shall be furnished to the state controller, to the state agency which is audited, to each member of the committee, and to the legislative council.

(3) Report immediately in writing to the attorney general any apparent violation of penal statutes disclosed by the audit of a state agency, and furnish the attorney general all information in his possession relative to the violation.

(4) Report immediately in writing to the governor any instances of misfeasance, malfeasance or nonfeasance by a state officer or employee disclosed by the audit of a state agency.

(5) Report immediately to the surety upon the bond of any official or employee when an audit discloses a shortage in the accounts of the official or employee. The failure to notify the surety does not release the surety from any obligation under the bond.

(6) Report to the legislative assembly during the first week of each regular session. Each biennial report shall contain, among other things, copies of, or summaries of audit reports on state agencies and any recommendations relating to such reports.

Section 9. **Audit standards and objectives.** The objectives of audits of state agencies conducted by the legislative auditor are to determine whether

(1) The agency is carrying out only those activities or programs authorized by the legislative assembly and is conducting them efficiently and effectively.

(2) Expenditures are made only in furtherance of authorized activities and in accordance with the requirements of applicable laws and regulations.

(3) The agency collects and accounts properly for all revenues and receipts arising from its activities.

(4) The assets of the agency or in its custody are adequately safeguarded and controlled and utilized in an efficient manner.

(5) Reports and financial statements by the agency to the governor, the legislative assembly, and central control agencies disclose fully the nature and scope of the activities conducted, and provide a proper basis for evaluating the agency's operations.

Section 10. **Recommendations of legislative auditor.** The reports of the legislative auditor may include comments, recommendations and suggestions, but he shall have no power to enforce them nor shall he otherwise influence or direct executive or legislative action.

Section 11. **Legislative auditor to assist legislative assembly during sessions.** During sessions of the legislative assembly, the legislative auditor and his staff, when requested, shall assist the legislative assembly, its committees, and its members by gathering and analyzing information relating to the fiscal affairs of state government.

Section 12. **Information from state agencies.** All state agencies shall aid and assist the legislative auditor in the auditing of books, accounts and records. The legislative auditor may examine at any time the books, accounts and records, confidential or otherwise, of a state agency; however, this shall not be construed as authorizing the publication of information which the law prohibits publishing.

Section 13. **Audit charge against earmarked money.** (1) As used in this section

(a) "Earmarked money" means a fund, account or any other money, other than general fund money, but excluding trust or agency money, that is earmarked for the support of a particular program or service.

(b) "Audit charge" means the actual cost of the audit of a state agency by the legislative auditor as computed by the legislative auditor, but not more than seventy-five dollars (\$75.00) per day.

(2) At the request of the legislative auditor, a state agency shall transfer to the general fund from earmarked moneys under its control an amount equal to the audit charge multiplied by the percentage that the annual expenditure of earmarked moneys is of the total annual expenditure of the state agency.

Section 14. Section 82-1002, R.C.M. 1947 is amended to read as follows:

"82-1002. **Duties of state examiner.** The duties of the state examiner and his assistants are:

1. To examine at least once in each year the books and accounts of the state treasurer, [state auditor, secretary of state,] clerk of the supreme court, [state game warden, register of state land office, and all other state officers having the collection or handling of state money,] county treasurers, county clerks, county assessors, district court clerks, county auditors, sheriffs, public administrators, boards of county commissioners of each county, and all other *county and municipal* officers, [and] boards *and institutions*. [whether temporary or permanent, however created and for whatever purpose, having the control, management, collection or disbursement of any public moneys of any character or description.]

2. To prescribe the general methods and details of accounting for the receipt and disbursement of all moneys belonging to the counties, cities, towns, or school districts, [and the educational, charitable, penal, and reformatory institutions of the state of Montana,] and to establish in all such offices such general methods and details of accounting as are required by law or are prescribed by the state examiner, and all county, city, town or school district officers, [and officers of educational, charitable, penal and reformatory institutions of the state of Montana] are hereby compelled to conform therewith.

[3. To examine at least once each year the books and accounts of the treasurer and secretary of each and all of the educational, charitable, penal and reformatory institutions of the state of Montana, and to examine into the financial affairs and conditions of each and all of said institutions.]

[4.] 3. To visit each and every office of the officers, boards and institutions named in this act at least once in each year; and at such time to examine the books, accounts and vouchers in

said office, to verify statements of receipts and expenditures, and indebtedness, and to examine and pass upon the character and amounts of any commissions, percentage, or charges for services, exacted by any officer, and of all claims allowed by any of said officers, boards or institutions.

[5.] 4. To visit twice each year, or oftener, without previous notice, each of the banks, banking corporations and saving banks, building and loan associations, investment and loan companies incorporated under the laws of this state, or doing business under any law of the state concerning corporations, and to examine into their affairs and ascertain their financial condition; to inspect and verify the value and the amount of their securities and assets, and to inquire into any violation of laws governing such banks, institutions, building and loan associations.

[6.] 5. The state examiner, after examination of the affairs of any [state officer, board, or institution, or] *officer or* board of county commissioners, must make report to the governor and to the attorney general of the result of such examination, within sixty days thereafter; and if any violation of law or non-performance of duty is found on the part of any such officer or board, they must be proceeded against by the attorney general or county attorney as provided by law.

[7.] 6. The state examiner, or his assistants, after the examination of the affairs of any county officers, must make report of such examination to the board of county commissioners and to the county attorney of such county, within thirty days after such examination; and if any violations of law or non-performance of duty is found on the part of any county officer or board, such officer or board must be proceeded against by the county attorney of the county as provided by law.

[8.] 7. The state examiner must make an annual report to the governor immediately after the end of each fiscal year. [but such report must not be printed unless the printing thereof be ordered by the state board of examiners.]

[9.] 8. It shall be the duty of the county attorneys of the various counties of the state of Montana and the city attorneys of the various cities and towns of the state of Montana to make report to the state examiner within thirty days after receiving from the state examiner the report of any examination of any county, city or town, as to what proceedings he has instituted or is intending to institute relating to violations of law and non-performance of duty, as set forth in the report of the state examiner.

[10.] 9. If any county or city attorney refuses or neglects to notify the state examiner within thirty days after receiving the report of any examination of any county, city or town, as to what proceedings he has instituted or is about to institute against any officer for violations of law or non-performance of duty, as evidenced by matters of record, and as set forth in the state examiners report, the state examiner may withhold the salary of such county or city attorney by filing notice with the proper officials, until proper and satisfactory explanation has been made to the state examiner for such non-performance of duty, provided further, that should the county or city attorney fail or refuse to prosecute such cases, the state examiner may employ an attorney to prosecute such case at the expense of the county, city, or town."

Section 15. Section 82-1005, R.C.M. 1947 is amended to read as follows:

"82-1005. **Power to examine books and papers.** The state examiner or his assistant has power to examine any books, papers, accounts, and documents in the office or possession of any county [or state officer,] or banking or other institution referred to in this act, and to send for persons or papers and to examine under oath any and all persons concerning the same."

Section 16. Section 82-1007, R.C.M. 1947 is amended to read as follows:

"82-1007. **Access to accounts of public officers—actions to compel.** (1) The state examiner shall have full power and authority to count the cash, verify the bank accounts and verify any and all accounts of any public officer whose accounts he is examining pursuant to law.

(2) Any [state,] county, city, town or school district officer who shall refuse to accord the state examiner access during an examination of such officer's accounts, to his cash, bank accounts, or any of the papers, vouchers or records of his office, or if the state examiner, after counting the cash and verifying the bank accounts of such officer shall find that a shortage exists in the accounts of said officer, the state examiner shall forthwith file a verified preliminary report showing the refusal of such officer to accord to him access to the examination of such accounts, cash, bank accounts, papers, vouchers or records, or the existence of such shortage, and the amount or approximate amount thereof [with the secretary of state if such officer shall be a state officer,] with the board of county commissioners of the proper county if the officer be a county or school district officer, and with the city or town council if the officer be a city or town officer; upon the filing of such verified statement, such officer shall immediately be suspended from the duties and emoluments of his office, [and the governor, in the case of a state officer,] and the board of county commissioners of the county in case of county or school district officers, and the city or town council in case of a city or town officer, shall appoint some qualified person to such office, pending the completion of such examination.

(3) Upon the completion of the audit or examination of the accounts of such officer by the state examiner, if a shortage shall be found to have existed in the accounts of such officer on the date of the commencement of such examination, the state examiner shall file, in the office of [the secretary of state in case of a state officer, and] the board of county commissioners of the proper county in the case of a county or school district officer, and with the city or town council in the case of a city or town officer, a verified final report of the examination or audit, showing such shortage, whereupon the right of such officer to such office shall be forfeited, and such office shall thereupon become vacant as of the date of the suspension of such officer as hereinabove provided, and the person appointed to such office upon the suspension of said officer shall hold said office until the election and qualification of his successor, as provided by law.

(4) Any officer whose right to office has been forfeited may, within ten days after the filing of the state examiner's final report or audit as herein provided, institute in the district court of the proper judicial district, a proceeding in quo warranto to test the right of his successor to hold such office, and the accuracy of the said final report and audit of the state examiner."

Section 17. Section 82-1009, R.C.M. 1947 is amended to read as follows:

"82-1009. **Laws applicable to such examinations.** That all laws now in force relative to the examination of the books and accounts of [state and] county officers, are, and the same are hereby declared to be applicable to the examination of the books and accounts of incorporated cities and towns, and to the books and accounts of school districts of the first and second class."

Section 18. Section 82-110, R.C.M. 1947 is amended to read as follows:

"82-110. **[Duties of] Controller to prescribe—[to act with state auditor and state examiner]—uniform accounting system—[examinations.]** (a) The controller, [acting with the state examiner,] shall prescribe and install uniform accounting and reporting for the several state boards, bureaus, departments, commissions and institutions showing the receipt, use and disposition of all public money and property, and shall develop plans for improvements and economies in the organization and operation thereof which shall be submitted to the respective heads of such boards, bureaus, departments, commissions and institutions. Copies of all such plans shall be delivered to the governor and additional copies shall be retained in the office of the controller for inspection by the members of the legislative assembly.

(b) The controller shall [receive copies of all audits and reports of the state examiner relating to all state departments, boards, bureaus, institutions and agencies and, without duplicating work done in preparing such audits and reports, he shall] have the power and it shall be his duty to examine into all financial affairs of every state board, commission, bureau, department

and institution for the purpose of developing plans for improvements and economies in the organization and operation thereof, and for the purpose of enabling him to properly perform any of the duties imposed upon him by this act.

(c) All officers, employees and other persons connected with the fiscal affairs of any state office, board, bureau, department, commission or institution must afford all reasonable facilities for the examination of accounts and investigations provided for in this act, and must make reports, returns and exhibits relating to such fiscal matters to the controller in such form as he shall prescribe; and the controller shall have and keep in his office the names of and amount of salary paid to each person regularly employed by the state of Montana and every agency thereof.

(d) If any officer or employee of the state or any agency thereof shall refuse or neglect to comply with subdivision (c) of this section, the salary of such officer or employee shall, on request of the controller to the proper official, be withheld until such recreant officer or employee shall comply therewith and the controller certifies approval to the disbursing officer."

Section 19. Section 71-206, R.C.M. 1947 is amended to read as follows:

"71-206. **Records to be maintained and reports rendered.** The state department of public welfare shall maintain such records and render such reports as may be required by the federal board and such additional records and reports as shall be found necessary for state purposes or required by the state [examiner] *controller*. County departments shall likewise be required to maintain such records and render such reports as the state board may require.

[All receipts of monies, goods or property and all disbursements therefrom shall be subject to examination and audit by the state examiner.]

The fiscal rules and regulations of the United States government, as enjoined upon the states in respect to the federal social security act, shall be used by the state and county departments as a method of accounting for all joint federal state funds."

Section 20. Section 4-347, R.C.M. 1947 is amended to read as follows:

"4-347. **Revenue to be paid to state treasurer—[audit of books]—disposition of revenue.** All fees, charges, taxes and revenues collected by or under authority of the Montana liquor control board, under the Montana beer act shall be paid over to the state treasurer on or before the tenth day of each and every month who shall deposit said funds to the credit of the state general fund, [and the state examiner shall annually audit the books of the board in order to determine that the amount of money received as shown by the books of the board correspond with the books of the state treasurer."]

Section 21. Section 4-230, R.C.M. 1947 is amended to read as follows:

"4-230. **When balance sheet and profit and loss statement to be made.** [Effective July 1, 1940] The accounts of the board shall be made up for the fiscal year ending June 30 in each year. [and at such other times as may be required by the state examiner; and] In every case the board shall prepare a balance sheet and statement of profit and loss and submit the same to the state [examiner] *controller*."

Section 22. Section 4-231, R.C.M. 1947 is amended to read as follows:

"4-231. **Reserve fund may be created.** From the profits arising under this act, [as certified by the state examiner,] there shall be taken such sums as may be determined by the board for the creation of a reserve fund to meet any loss that may be incurred by the state in connection with the administration of this act, or by reason of its repeal."

Section 23. Section 5-910, R.C.M. 1947 is amended to read as follows:

"5-910. **Special examination and fees.** Special examinations may be made of any county, city, town, school district, irrigation district, high school, bank, building and loan association, credit union or any other *county or municipal* office, board or commission, whether temporary or permanent, however created, and for whatever purpose, having the control, management, collection or disbursement of any public money of any character or description, when in the judgment of the state examiner it shall be deemed necessary, and such special examinations shall be charged for at the rate of sixty dollars (\$60.00) a day for each person engaged in the examination. All special examination fees or charges so collected by the state examiner and ex officio superintendent of banks and paid to the state treasurer, shall be placed in a special fund to be known as the special examination fund to be drawn upon by the state examiner and ex officio superintendent of banks to defray the actual costs and expenses of such special examinations, but all moneys remaining in such special fund at the end of each current year shall be transferred by the state treasurer to the general fund.

In any case where the current examination shall not have been made prior to the first day of July of any year, the above fees must be paid as herein specified, provided, however, that all examinations shall cover the entire period from the date of the last examination."

Section 24. Sections 82-1014, 82-1015, 82-1016, R.C.M. 1947 enacted as Sections 1, 2 and 3, Chapter 279, Laws of 1959, and sections 79-504, 84-4403, 84-4404, 84-4405 and 89-403, R.C.M. 1947 are repealed.

Section 25. Sections 1 through 13 and section 25 of this act are effective on passage and approval. Sections 14 through 24 of this act are effective July 1, 1963.

